Cancorp

FATHOM
OCEANOLOGY LIMITED

1975
ANNUAL REPORT

FOR THE YEAR ENDED MARCH 31, 1975

Directors

*K. R. OLSEN, Hudson, Quebec.
President, Fathom Oceanology Limited,
Vice President, Atlas Construction Limited,
President, G. M. Gest Ltd. & Subsidiaries.

*R. L. I. FJARLIE, Maxville, Ontario.
Executive Vice President, Fathom Oceanology Limited.

*N. E. HALE, Mississauga, Ontario.
Vice President Engineering, Fathom Oceanology Limited.

*J. B. FOOTE, Cambellcroft, Ontario
Marketing Manager, G. F. Business Equipment Incorporated.

K. GARDNER, Mississauga, Ontario.
Vice President Marketing, Fathom Oceanology Limited.

J. E. NORDIN, Montreal, Quebec.
General Manager, Quebec Region, Industrial Development Bank.

*Member of the Executive Committee

Officers

K. R. OLSEN, President
R. L. I. FJARLIE, Executive Vice President
N. E. HALE, Vice President
K. GARDNER, Vice President
J. O. EMPEY, Vice President
D. W. FAIRLES, Treasurer and Financial Controller
R. A. DONALDSON, Secretary

Head Office and Plant
863 Rangeview Road, Port Credit, Ontario.

Subsidiary Company
Hale & Associates Limited, Port Credit, Ontario.

Transfer Agent and Registrar
National Trust Company Limited, Toronto, Ontario and Calgary, Alberta.

Banker
Bank of Montreal, Toronto, Ontario.

Auditors
Clarkson, Gordon & Co., Toronto, Ontario.

Legal Counsel
Blake, Cassels & Graydon, Toronto, Ontario.

The annual meeting of the shareholders of Fathom Oceanology Limited will be held in the Library Room of the Royal York Hotel, Toronto at 2:00 P.M. on the 27th day of August 1975

FATHOM OCEANOLOGY LIMITED

(Incorporated under the laws of Canada)

To the Shareholders of
Fathom Oceanology Limited

Summary

Compared with last year:

Revenue from all sources rose	30% to $931,000
Revenue from re-use of design assets rose	71% to $684,000
Revenue from new designs fell	6% to $235,000
Revenue from Government assistance fell	85% to $ 12,000

Loss for the year was $130,000 or 9¢ a share compared with $246,000 or 21¢ a share last year.

The large contract taken in 1971 which was the major cause of losses since that time was completed at the end of the fourth quarter.

Completed Contracts and Work in Progress

The contract placed in 1971 for two V.D.S. Systems for the Brazilian Navy was completed on schedule. The first of these two systems was delivered early in 1974 and met all performance specifications. The second system was completed in March and, after providing Navy personnel with training opportunities, was shipped in May.

A system for geological study in the North Atlantic and the Labrador Sea was delivered in August. This unit is being operated under the auspices of the Government of Canada, Department of the Environment.

Two other small but significant orders were for large cable fairings. One order came from the French Navy and the other from the Government of Japan.

Prepairing a Fathom "RAYFISH" equipped with sub-bottom profiling instruments for an exploration survey in the Great Lakes

Work now in the plant includes five sonar domes to existing design for export to the United States as components of equipment for the Spanish Navy. This contract is repeat business and makes use of Fathom designs developed and paid for in earlier years.

Also under constructrion for a West German scientific group is a winch system that will be used to launch and recover a towed device employed in deep water sampling. This, once again, is repeat business using designs developed a few years ago.

In the new design area is the construction of a launching and recovery facility for a towed line array (TLA) system. Unlike the variable depth sonar or V.D.S. system the T.L.A. uses a very long flexible plastic oil filled tube that carries an array of hydrophones distributed over its length. This is important new business and its successful development augurs well for the future.

The value of work on hand on April 1, 1975 was $509,000. This compares with $419,000 on the same date a year earlier.

During the current period work is progressing on seven contracts with the United States, five with Canada and others with Germany, England, Japan, France, Italy, Sweden, The Netherlands and Australia.

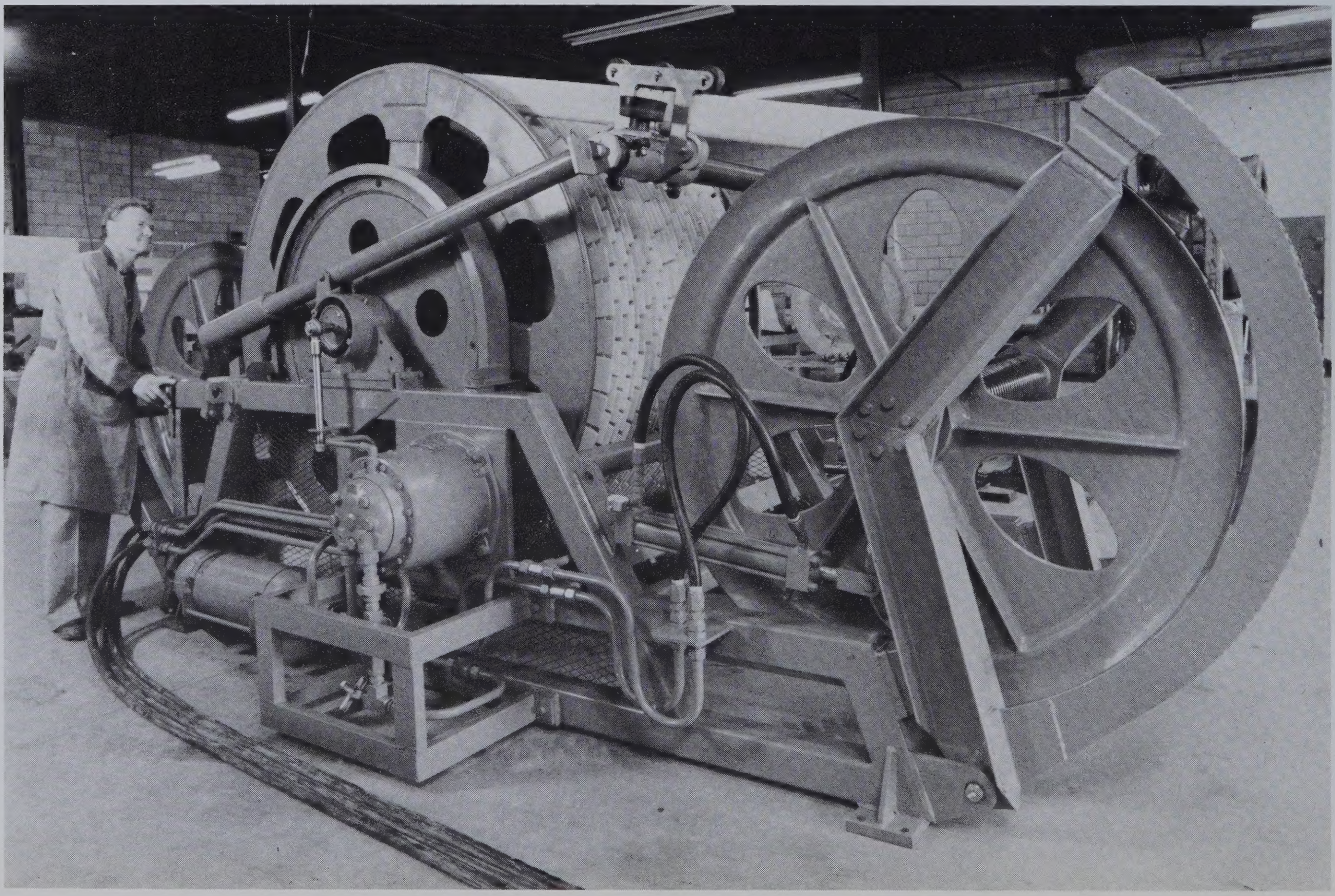
Financial Affairs

The cause of the loss this year is centered on the major contract taken in 1971 for two complete systems destined for the Brazilian Navy. The escalation of prices of both labour and materials that was not anticipated four years ago when the contract was signed has been one of the major causes of the annual loss since that time. This work was finished at the end of the fourth quarter.

All three months of the fourth quarter were profitable and there are indications that this situation will continue. Excluding all forms of Government assistance, revenue increased during 1975 by 43% to $919,000. In spite of this sizeable increase in volume, direct costs of manufacturing and product design increased by only 22% to $783,000, and administrative costs including interest were held to a minimal 3% increase during a year of high inflation.

During the early years of Fathom's existence considerable money was invested in the development

A Fathom towing system ready for shipment to West Germany for water sampling studies in the Baltic Sea



of designs and the production of prototypes. Since the cost of this work could not be fully recovered in the sale price, heavy losses were recorded each year. Conservative accounting practices showed "completed engineering designs" with an asset value of one dollar. The value of the asset, which has been shared equally between Fathom and the Federal Government, was in fact worth $1,200,000 at the end of financial 1975.

In 1972 profitable repeat business including use of these design assets began. It grew 80% in 1973, a further 344% in 1974 and in 1975 increased another 71% to a total of $684,000. Satisfied customers came back for more.

Other customers around the world continue to test Fathom prototypes and are finding them highly satisfactory.

The Outlook

Prospects for the further growth of Fathom Oceanology continue to be encouraging. There is continued interest in the oceans of the world as a source of food and energy and, in the quest for undersea information, the Fathom system has proved itself a very useful tool.

Military interest is also expanding. As prototypes are proven repeat orders are being placed. Considerable product innovation is a necessity in this market and new design assets are being added to those already held. Several new patents were issued to the company during the year.

Staff

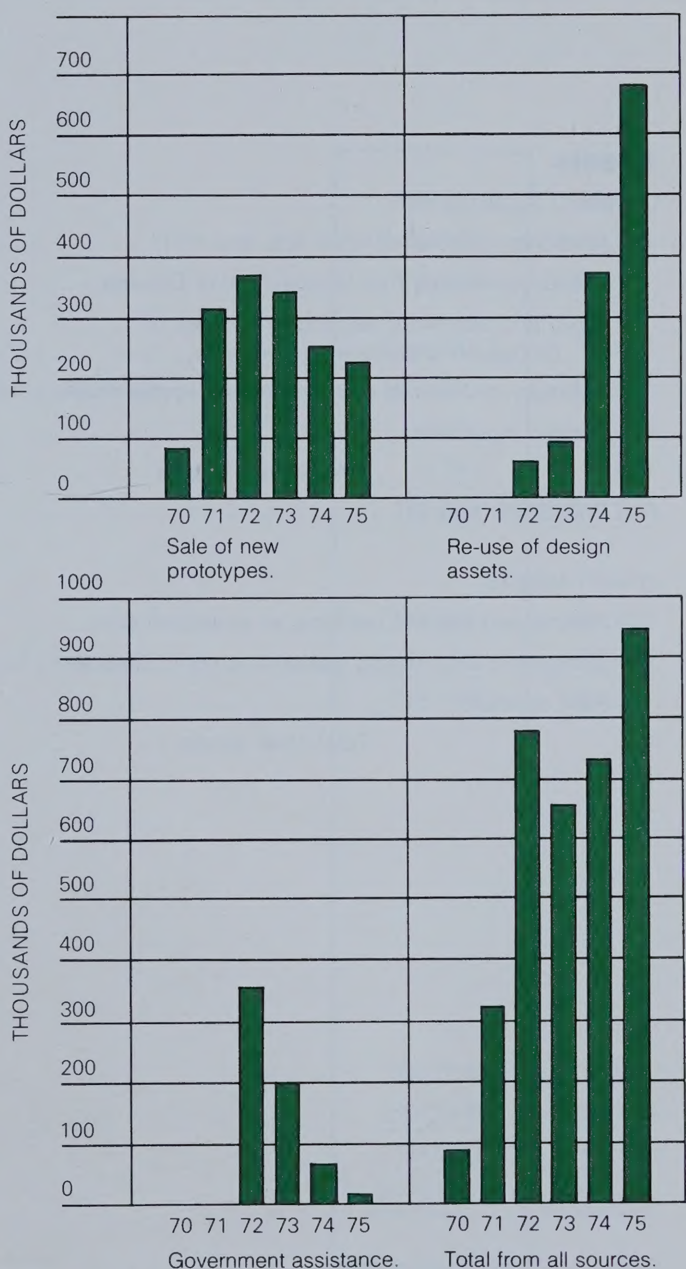
The number of persons employed by the company at the end of the financial year was 32. They operate as a team. Many have been with the company since its formation and have made contributions in time that have frequently extended far beyond the normal working periods. To these dedicated employees the Directors express their thanks.

By Order of the Board of Directors.

Haare Olsen.

K. R. Olsen,
President.

SOURCES OF REVENUE



Note the dramatic increase in the source of revenue from re-use of design assets. This is repeat business. Customers who ordered prototypes have satisfied themselves on product suitability and are now coming back for more of the same.

New development work continues but has leveled off and the need for government assistance is passing.

FATHOM OCEANOLOGY LIMITED

(Incorporated under the laws of Canada)

Consolidated Balanc
(with comparative fi

Assets

	1975	1974
CURRENT ASSETS:		
Accounts receivable (notes 4(a) and 4(c))	$181,269	$176,740
Grants receivable from Government of Canada	—	18,639
Costs and estimated earnings in excess of billings on uncompleted contracts	132,170	110,990
Inventory, at lower of cost and net realizable value	27,037	41,435
Prepaid expenses	3,054	5,321
Total current assets	343,530	353,125
FIXED ASSETS (note 3)	112,272	116,676
OTHER ASSETS:		
Patents and patents pending, at amortized cost	79,589	89,301
Completed engineering designs, at nominal value	1	1
Rent deposits	10,213	10,213
Total other assets	89,803	99,515
	$545,605	$569,316

On behalf of the Board:

K. R. OLSEN, Director

R. L. I. FJARLIE, Director

(See accompanying notes)

eet at March 31, 1975
s at March 31, 1974)

(Statement 1)

Liabilities

	1975	1974
CURRENT LIABILITIES:		
Bank indebtedness (note 4(c))	$ 90,957	$156,715
Accounts payable and accrued charges	158,539	164,137
Billings in excess of costs and estimated earnings on uncompleted contracts	64,847	56,698
Due to Ontario Development Corporation—export support loan (note 4(a))	150,000	151,507
Employee income and other taxes payable	9,597	9,063
Current portion of venture capital loan	8,280	7,656
Total current liabilities	482,220	545,776
NON-CURRENT LIABILITIES:		
12% convertible notes payable (note 4(b))	184,050	184,050
Due to Ontario Development Corporation—venture capital loan (note 4(a))	74,196	82,476
Total non-current liabilities	258,246	266,526
CAPITAL AND DEFICIT:		
Share capital (note 5)		
Authorized:		
3,000,000 (2,000,000 in 1974) common shares without nominal or par value		
Issued:		
1,478,667 (1,181,667 in 1974) common shares	690,818	512,622
Deficit (statement 2)	(885,679)	(755,608)
	(194,861)	(242,986)
	$545,605	$569,316

Auditors' Report

To the Shareholders of
FATHOM OCEANOLOGY LIMITED

We have examined the consolidated balance sheet of Fathom Oceanology Limited and its subsidiary as at March 31, 1975, and the consolidated statements of operations and deficit and changes in financial position for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the companies as at March 31, 1975, the results of their operations and the changes in their financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada
May 13, 1975

CLARKSON, GORDON & CO.
Chartered Accountants

FATHOM OCEANOLOGY LIMITED

(Incorporated under the laws of Canada)

Consolidated Statement of Operations and Deficit

(Statement 2)

for the year ended March 31, 1975
(with comparative figures for 1974)

	1975	1974
REVENUE	$ 918,977	$ 641,086
COSTS:		
Manufacturing	777,070	625,170
Administrative	226,663	218,850
Product design (note 2(b))	6,164	17,743
Interest—long-term	28,916	29,915
Interest—short-term	19,128	18,083
	1,057,941	909,761
Less recovery of costs by grants from Government of Canada (note 2(a))	(8,893)	(22,134)
Net costs	1,049,048	887,627
NET LOSS FOR THE YEAR	130,071	246,541
DEFICIT, BEGINNING OF YEAR	755,608	509,067
DEFICIT, END OF YEAR	$ 885,679	$ 755,608
NET LOSS PER SHARE	$ 0.09	$ 0.21

(See accompanying notes)

FATHOM OCEANOLOGY LIMITED

(Incorporated under the laws of Canada)

Consolidated Statement of Changes in Financial Position

(Statement 3)

for the year ended March 31, 1975
(with comparative figures for 1974)

	1975	1974
FUNDS WERE RECEIVED FROM:		
Issue of common shares (note 5(a))	$ 178,196	—
Grant for fixed assets from Government of Canada (note 2(a))	—	$ 33,679
Total funds received	178,196	33,679
FUNDS WERE APPLIED TO:		
Operations—		
Net loss for the year	130,071	246,541
Less charges to operations not involving an outlay of working capital:		
Depreciation and amortization of fixed assets	(42,245)	(43,349)
Amortization of patents and patents pending	(13,561)	(9,726)
Funds applied to operations	74,265	193,466
Reduce long term debt (note 4(a))	8,280	7,657
Purchase of fixed assets	37,841	93,867
Cost of patents and patents pending	3,849	14,610
Purchase of minority interest in subsidiary	—	12,480
Total funds applied	124,235	322,080
Increase (decrease) in working capital during the year	$ 53,961	$(288,401)
Changes in components of working capital:		
Increase (decrease) in current assets—		
Short term deposit	—	$(150,000)
Amounts receivable	$ (14,110)	73,564
Uncompleted contracts (net)	13,031	19,606
Inventory	(14,398)	(2,475)
Other	(2,267)	(4,601)
	(17,744)	(63,906)
(Increase) decrease in current liabilities —		
Bank indebtedness	65,758	(100,547)
Amounts payable	5,064	(89,220)
Ontario Development Corporation	883	(34,728)
	71,705	(224,495)
Increase (decrease) in working capital during the year	53,961	(288,401)
WORKING CAPITAL (DEFICIENCY), beginning of year	(192,651)	95,750
WORKING CAPITAL (DEFICIENCY), end of year	$(138,690)	$(192,651)

(See accompanying notes)

FATHOM OCEANOLOGY LIMITED

(Incorporated under the laws of Canada)

Notes to Consolidated Financial Statements March 31, 1975

1. Accounting policies

The following is the summary of certain significant accounting policies followed in the preparation of the consolidated financial statements. The policies conform to generally accepted accounting principles and have been applied consistently.

(a) Basis of consolidation —

The consolidated financial statements include the accounts of the company's wholly-owned subsidiary, Hale & Associates Limited.

(b) Contracts in progress —

Profits on contracts in progress are recorded by the percentage of completion method. Complete provision is made for losses on contracts in progress when they first become known. In the case of contracts extending over one or more years, revisions in cost and profit estimates, which can be significant, are reflected in the accounting period in which the relevant facts become known.

(c) Fixed assets —

Fixed assets are recorded at acquisition cost. Where government grants are received specifically for a particular fixed asset, the cost of that asset is reduced by the amount of the government grant. Depreciation is recorded in the accounts on the declining balance basis at the following rates:

Equipment and ship ocean simulator	20%
Patterns and tooling	33 1/3%

Leasehold improvements are amortized according to the straight line method over the term of the lease. Costs of repairs to fixed assets which extend the useful life of an asset are capitalized. All other costs of repairs and maintenance are charged to operations as incurred.

(d) Research and development —

Research and development costs, excluding costs of patents and patents pending, are charged to operations as incurred. Where government grants are received for research and development, these grants are deducted from the research and development costs.

(e) Patents and patents pending —

The costs incurred for patents and patents pending are capitalized. The costs incurred to March 31, 1971 are being amortized over the projected sales to March 31, 1978. Costs subsequent to March 31, 1971 are being amortized on a straight line basis over a ten year period.

(f) Engineering designs —

Costs of engineering designs are charged to operations as incurred.

2. Research and development

(a) On February 24, 1972, the company contracted with the Government of Canada under the Defence Industries Productivity (D.I.P.) program to continue the design and development of its towing systems. The Department agreed to contribute 50% of defined expenditures by the company on this project before July 1974. This term has now been extended to June 1975. Under the terms of the contract, the amount contributed by the Government shall not exceed $602,500 of which $7,500 (in respect of operating costs) has been reflected in the statement of operations in 1975 ($20,039 in 1974, $187,537 in 1973 and $311,169 in 1972) and $76,255 (in respect of fixed assets) has been reflected as a reduction in the cost of fixed assets on the balance sheet. While the Government is contributing these funds, in certain circumstances it can require partial or complete repayment of the grant. With Government approval, the company, rather than repaying the grants, can reinvest the funds in future development projects.

(b) Effective April 1, 1973, the company contracted with the Government of Canada under the Program for the Advancement of Industrial Technology (P.A.I.T.) to undertake a specific project for the design of a new towing system. The Government agreed to contribute 75% of defined expenditures by the Company on this project (but not more than $56,100), of which 25% represents a loan repayable on a royalty basis in the event of any sale of the fully developed system. To March 31, 1975, the company had incurred costs on this project of $80,007 ($70,981 in 1974) of which $56,100 ($53,238 in 1974) has been recovered, resulting in a net cost to March 31, 1975 of $23,907. No portion of the P.A.I.T. grant has been reflected as a potential liability because any sale of the fully developed system is uncertain at this time.

3. Fixed assets

	Original cost	Government grant (note 2(a))	Accumulated depreciation and amortization	Net book value 1975	Net book value 1974
Equipment	$ 61,808	—	$ 38,587	$ 23,221	$ 25,301
Ship ocean simulator	93,545	$41,633	24,317	27,595	25,660
Leasehold improvements ..	25,796	—	13,759	12,037	14,579
Patterns and tooling	185,566	34,622	101,525	49,419	51,136
Total fixed assets	$366,715	$76,255	$178,188	$112,272	$116,676

Reference is made to note 4(a).

4. Loans and notes payable

(a) Ontario Development Corporation (O.D.C.) —

In 1973, the company entered into an agreement with O.D.C. under which O.D.C. agreed to advance an 8% venture capital loan of $100,000 and a 6½% export support loan of up to $150,000. The venture capital loan is being repaid over 10 years in blended monthly payments of principal and interest of $1,206. The export support loan is available to provide funds upon the receipt of a contract to finance the manufacture and sale of equipment for export. Loans are repayable out of amounts received from the relevant contracts, or on demand.

The loans are secured by:

(i) chattel mortgage on all equipment owned by the company,

(ii) a floating charge on all assets (except accounts receivable required to secure any bank loans — reference is made to note 4(c)),

(iii) an assignment and postponement for ten years of 12% convertible notes outstanding as described in note 4(b),

(iv) an assignment of fire and export insurance policies,

(v) an assignment of specific accounts receivable related to sales financed under the export support loan program.

During the year, the company applied to O.D.C. for and obtained approval in principal of an increase in the maximum level of the export support loan from $150,000 to $500,000. The company is currently fulfilling the necessary conditions in order to finalize this agreement.

(b) 12% convertible notes —

Under the terms of an agreement signed by the noteholders in favour of the Ontario Development Corporation, the 12% convertible notes cannot be redeemed until all loans from the Ontario Development Corporation have been repaid. Reference is made to note 4(a).

The notes are convertible at a price of $0.60 per share in whole or in part, at the option of the noteholder, into fully-paid and non-assessable shares of the company.

(c) Bank indebtedness —

The bank loan is secured by a general assignment of those book debts not assigned to the Ontario Development Corporation. Reference is made to note 4(a).

5. Share capital

(a) On April 10, 1974, a major Canadian financial institution purchased 297,000 treasury common shares for a net cash consideration of $178,196.

(b) During the year, the company obtained Supplementary Letters Patent increasing the authorized share capital to 3,000,000 shares without nominal or par value.

(c) Under the terms of a stock option plan, 200,000 shares have been reserved for senior officers (150,000 shares) and key employees (50,000 shares) exercisable at a price equal to 90% of the market value of the shares on the date of granting the options. As at March 31, 1975, the company had granted options to purchase 75,000 shares to two senior officers and 40,000 shares to key employees at an option price of $0.405. During the year, an option to purchase 5,000 shares previously granted to a senior officer expired upon his resignation.

All of the share options are exercisable in the following percentages commencing with the date the option is granted:

	Percentage of original option exercisable
During the 1st year of option	33⅓%
During the 2nd year of option	66⅔%
During the 3rd year of option	100%

The company has reserved the following unissued common shares:

For stock options	200,000 shares
For 12% convertible notes payable (note 4(b))	306,750 shares
	506,750 shares

6. Commitment

At March 31, 1975, the company had a commitment under a premises lease to pay rent at an annual rate of approximately $30,000 up to November 30, 1979.

7. Losses carried forward for income tax purposes

The company has incurred losses to March 31, 1975 totalling $846,000 which can be carried forward for income tax purposes to be applied against any future income of the company within the time limits prescribed by law.

8. Statutory information

In accordance with Section 122.2 of the Canada Corporations Act, it is reported that during the year there were seven directors who received no remuneration as directors and eight officers (including one former officer) who received $125,270 as officers. During the year, four directors were also officers.

FATHOM